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Carolyn Walsh, Esq.
Senior Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

RE: Comments to Proposed Amendment and Interpretations of Rule G-37

Dear Ms. Walsh:

The Bond Market Association ("Association") [1] appreciates this opportunity to respond to the notice ("Notice") issued by the Municipal Securities Rulemaking Board ("MSRB") on February 15, 2005, in which the MSRB proposed an amendment to Rule G-37 and certain Questions and Answers ("Q&As") regarding the ability of broker-dealers and municipal finance professionals ("MFPs") to make and solicit contributions to political party committees and PACs.[2] In particular, the proposed amendment absolutely prohibits broker-dealers and MFPs from soliciting contributions to state and local party committees while the proposed Q&As set forth new due diligence standards for making contributions to party committees and PACs. The proposed Q&As also suggest that informational barriers be erected between a broker-dealer and affiliated PACs that give to issuer officials. The Association continues to support the principles underlying MSRB Rule G-37, and the strict enforcement of all MSRB rules. To that end, the Association fully supports the MSRB's efforts to eliminate any vestiges of pay-to-play in the municipal securities industry, whether they be in the form of a direct or indirect contribution to an issuer official.

However, the Q&As are vague, thus making it impossible for broker-dealers to know exactly what standard to apply. We request that the MSRB (1) clarify the proposed Q&As as they relate to contributions to party committees and PACs so that they establish clear standards upon which the industry may rely; (2) acknowledge that the proposed Q&As reflect a new approach to Rule G-37's

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1 The Association represents securities firms and banks that underwrite, distribute and trade fixed income securities and other credit market instruments in the U.S. and globally. Additional information about the Association and its members and activities is located at www.bondmarkets.com.

2 MSRB Notice 2005-11.

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prohibition on indirect contributions and not just a restatement of some existing standard; (3) expressly state that contributions made to national party committees and certain federal leadership PACs (controlled by members of Congress) are permitted, given the lack of a nexus between these federal entities and state and local issuer officials; (4) modify the prohibition on soliciting contributions to a state or local party committee so that broker-dealers and MFPs would be permitted to solicit contributions to the same extent they are able to make a contribution to them; and (5) clarify what is meant by "affiliated PAC" for purposes of erecting an informational barrier.

1. Brief Description of Proposed Amendment and Q&As

Rule G-37 currently prohibits broker-dealers and MFPs from soliciting contributions on behalf of an issuer official. The proposed amendment would extend this prohibition on solicitation to state and local party committees.

As for the proposed Q&As' new due diligence standard for giving to party committees and PACs, different parts of the Q&As appear to set forth different, and sometimes even conflicting, standards. For example, Q&A 1 states that when giving to a party committee or PAC, a broker-dealer must make sure that its "money [is not used] for the support of one or a limited number of issuer candidates." This confirms the MSRB's prior interpretations that broker-dealers need only track how their contributions are used, thus permitting contributions to an account of a party committee that is not used to support candidates (such as a housekeeping or conference account). However, Q&A 2 states that giving to such housekeeping or conference account is not a safe harbor.

Although we cannot be sure from the language of the Q&As, it appears that the MSRB is creating a two-pronged due diligence requirement, under which the broker-dealer must: (1) gather and keep records of the underlying reasons for making a party committee or PAC contribution ("Underlying Reasons Test"); and (2) ensure that the party committee or PAC (as a whole and not just the account to which the contribution is made) does not "raise money to support one or a limited number of issuer officials" ("Activity Test").

To avoid an indirect violation of Rule G-37, the proposed Q&As also suggest that a broker-dealer erect an informational barrier between it (including its MFPs) and its "affiliated PAC," which gives to issuer officials. Under this barrier, the PAC would not be permitted to share information regarding its contributions with the broker-dealer and the broker-dealer would

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not be permitted to share information regarding its municipal securities business with the PAC.

2. The MSRB Should Acknowledge that the Q&As Reflect a Change in the MSRB's Interpretations

The MSRB has informally made public statements that these proposed Q&As are merely a restatement of an existing standard on political party and PAC contributions under Rule G-37 and that these Q&As do not reflect a change in the MSRB's views. The MSRB has also implied that broker-dealers have been somehow indirectly violating Rule G-37 by giving to so-called housekeeping or conference accounts of party committees.

However, these informal statements and implications raised by the MSRB are belied by not only one, but two formal interpretations issued by the MSRB specifically on this subject. In particular, in the two and only existing Q&As on this subject, the MSRB made clear that a broker-dealer's contribution to a party committee or PAC would not result in an indirect violation of Rule G-37 unless the broker-dealer knows that its contribution will go to issuer officials.[3] Moreover, the MSRB expressly established as a safe harbor where a broker-dealer gets assurances from a party committee or PAC that the broker-dealer's contribution will not be used for issuer officials.[4] This safe-harbor was also recognized in the Voluntary Initiative (a pre-cursor to Rule G-37 that was approved by the Securities and Exchange Commission), which expressly permitted contributions to "conference accounts" of state and local party committees.

Thus, far from attempting to skirt the requirements under Rule G-37, broker-dealers have been making an extra effort to qualify under this express safe harbor by giving to a party committee's housekeeping or conference account, which is not used to support any candidate. Please note that broker-dealers did not have to, under current MSRB interpretations, take this extra precaution in that most state party committees are very large and give to a wide variety of candidates, most of

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[3] One Q&A states that a "dealer would violate Rule G-37 by doing business with an issuer after providing money to any person or entity when the dealer knows that such money will be given to an official of an issuer who could not receive such a contribution directly from the dealer without triggering the rule's prohibition on business." MSRB Q&A III.4 (August 6, 1996)(emphasis added); see also Q&A III.5 (August 6, 1996).

[4] Q&A III.5 states that "[d]ealers should inquire of the non-dealer associated PAC or political party how any funds received from the dealer would be used." (August 6, 1996).

whom are not issuer officials (e.g., legislative candidates). There would be no reason for broker-dealers to know that their contributions to such state party committees would be used to go to issuer officials even if they did not give to these housekeeping or conference accounts, and thus no indirect contribution would result under the existing Q&As.

The due diligence concepts espoused in the MSRB's proposal are very different from the standards established under the existing Q&As. For example, as described above, the existing Q&As require that a broker-dealer track how its contribution to a party committee or PAC is used (where housekeeping or conference accounts are safe harbors), whereas the proposed Q&As require that broker-dealers look at the expenditures made by the party committee or PAC as a whole. Moreover, the proposal introduces the unprecedented concept of having to somehow reach into the mind of a contributor and pull out the reasons as to why the contribution was made. Given these significant departures from its existing interpretations, the MSRB's claim that it is not changing its standard on party and PAC contributions is unfounded and unduly casts aspersions on an industry which has gone above and beyond taking reasonable steps to comply with the Rule. Thus, we request that the MSRB clarify that these proposed Q&As constitute a new standard on making contributions to party committees and PACs.

3. The Standards in the Proposed Q&As Need to Be Clarified

Even if one were able to boil down the proposed Q&As to the two-pronged standard described in Section 2 above (i.e., the Underlying Reasons Test and the Activity Test), the standard is vague and thus cannot be applied. As a result, broker-dealers and their individual MFPs will, as a practical matter, be forced to shut down contributing any amount to a state or local party committee or PAC, regardless of the circumstances.

This is particularly troublesome given that for most broker-dealers, municipal securities business is only a small part of their total business and they have perfectly legitimate interests completely unrelated to municipal securities business in connection with which they make contributions. Indeed, as one of the most highly regulated industries, a wide variety of legislation, ranging from taxes to banking regulation, impact financial institutions. Broker-dealers have a legitimate and vested interest in supporting party committees to help elect legislators whose positions are good for the industry and the economy. Needless to say, MFPs as voting citizens have even further divergent political interests.

Moreover, unlike the other MSRB Rules, Rules G-37 and G-38 regulate political contributions, which is a form of free speech protected under the

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First Amendment of the Constitution.[5] It is well established that as protected speech, political contributions may not be regulated in a vague or overbroad manner.[6] In particular, unless a restriction on political contributions is clear and precise, it will unduly chill the legitimate exercise of this most important right and violate the Constitution.[7] Such chilling of free speech is exactly what will result from the vague nature of the proposed Q&As in that broker-dealers and MFPs will have to shut down giving to any state or local party committee or PAC because they have no clear standard to apply. Please note the MSRB cannot dismiss this important constitutional concern by simply pointing to the Blount v. SEC case (in which the

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5 The Courts have equated political contributions with protected First Amendment speech. *See, e.g., Buckley v. Valeo, 424 U.S. 1, 14-15 (1976).*

6 In *Buckley*, the Supreme Court specifically notes that vagueness is intolerable in laws impacting core First Amendment rights such as political speech. In particular, the Court calls for "[c]lose examination of the specificity of the statutory limitation" in "an area permeated by First Amendment interests." *Buckley*, 424 U.S. at 40-41 (citing *Smith v. Goguen*, 415 U.S. 566, 573 (1974); *Cramp v. Board of Public Instruction*, 368 U.S. 278, 287-288 (1961); *Smith v. California*, 361 U.S. 147, 151 (1959)). *See also FEC v. Christian Action Network*, 110 F.3d 1049, 1051-1052 (4th Cir. 1997). Indeed, "standards of permissible statutory vagueness are strict in the area of free expression." *NAACP v. Button*, 371 U.S. 415, 432 (1963) (citing *Smith v. California*, 361 U.S. 147, 151; *Winters v. New York*, 333 U.S. 507, 509-510, 517-518; *Herndon v. Lowry*, 301 U.S. 242; *Stromberg v. California*, 283 U.S. 359; *United States v. C.I.O.*, 335 U.S. 106, 142 (Rutledge, J., concurring)). *Buckley* also maintains that the application of a statute must "afford the '[p]recision of regulation [that] must be the touchstone in an area so closely touching our most precious freedoms.'" *Buckley*, 424 U.S. at 41 (quoting *NAACP v. Button*, 371 U.S. at 438). The Supreme Court also stated that "[b]ecause First Amendment freedoms need breathing space to survive, government may regulate in the area only with narrow specificity." *NAACP v. Button*, 371 U.S. 415, 433 (1963).

7 Regarding vague applications of law, the Court in *Buckley* warned of:

> ...not only "trap[ping] the innocent by not providing fair warning" or foster[ing] "arbitrary and discriminatory application" but also operat[ing] to inhibit protected expression by inducing "citizens to 'steer far wider of the unlawful zone... than if the boundaries of the forbidden areas were clearly marked.'" *Grayned v. City of Rockford*, 408 U.S. 104, 108-109 (1972), quoting *Baggett v. Bullitt*, 377 U.S. 360, 372 (1964), quoting *Speiser v. Randall*, 357 U.S. 513, 526 (1958).

Buckley, 424 U.S. at 41 n.48. *See also NAACP v. Button*, 371 U.S. at 433 (noting that the perils of vagueness and overbreadth stem from "the danger of tolerating, in the area of First Amendment freedoms, the existence of a penal statute susceptible of sweeping and improper application"); *Kolender v. Lawson*, 461 U.S. 352, 357-358 (1983).

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court upheld the constitutionality of Rule G-37) given that the decision was based on a Rule that allowed contributions to party committees and PACs.

If the MSRB's intent is to absolutely eliminate state and local party committee and PAC contributions, it should come out and do so with a clear prohibition rather than through a vague interpretation that casts uncertain doubt on all contributions.[8] Alternatively, the MSRB should clarify the Underlying Reasons Test and the Activity Test to give clear guidance as to what is prohibited.

a. The Reasons Test

Although the Underlying Reasons Test requires that broker-dealers determine and keep records of the reasons for making a contribution, it does not provide clear guidance as to what reasons are permissible and what reasons are not. For example, it is not uncommon for a company to contribute unsolicited annual dues to a state party committee as part of an ongoing commitment, under which it has been giving the same amount to that party committee for decades. Would this be an impermissible reason for contributing? To avoid such confusion and vagueness, we recommend that the Underlying Reasons Test be clarified to only cover contributions to party committees and PACs that are controlled by, or where the contribution is solicited by, an issuer official.

Unless the Underlying Reasons Test is clarified to be limited to such particular actions, it will be unconstitutional. Indeed, the courts have repeatedly made clear that political activity may not be regulated based on intent. The Constitution does not permit a regulator to look at a person's intent on a fact-by-fact basis in determining whether his or her political activity violated a particular law -- an exercise in mind-reading that is inappropriate in light of the vagueness and overbreadth requirements impacting First Amendment freedoms.[9] Again, such

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[8] Please note, however, that prohibiting contributions to state and local party committees or PACs is also fraught with constitutional problems. Indeed, it would be an overbroad restriction on First Amendment speech. Moreover, it would also violate the First Amendment right to association in that many party committees (especially local party committees) require voters to pay regular dues in the form of contributions to participate in that party committee's core functions. For example, to be able to vote for an endorsement by Washington State's 43rd District local Democratic Party, an individual must be a dues paying member of that local party. Thus, by prohibiting contributions (i.e., dues) to such party committee, an individual would be unduly restricted in his or her ability to associate with others and engage in core party activities.

[9] Indeed, a speaker cannot be left "'wholly at the mercy of the varied understanding of his hearers and consequently of whatever inference may be drawn as to his intent and meaning.'" *Buckley*, 424 U.S. at 43 (quoting *Thomas v. Collins*, 323 U.S. 516, 535 (1945)).

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regulation of political contributions leads to an unacceptable chilling of protected speech. In confirming the unconstitutionality of an intent-based regulation of political activity, the Eighth Circuit stated:

> Questions of intent ... are to be excluded from the analysis, since a speaker, in such circumstances, could not safely assume how anything he might say would be understood by others...When a definition depends on the meaning others attribute to the speech, there is no security for free discussion.[10]

b. The Activity Test

The Activity Test requires that a broker-dealer ensure that the party committee or PAC (as a whole and not just the account to which the contribution is made) does not "raise money to support one or a limited number of issuer officials." This language is unclear in that it could mean one of two things. One possible reading is that if a contribution is made to a party committee or PAC that supports even one issuer official, then an indirect ban is triggered. Under this strict reading, even a contribution to a national party committee (such as the Republican National Committee or Democratic National Committee), which raises hundreds of millions of dollars primarily to support non-issuer official federal candidates, would be prohibited if that party committee spends even one dollar on an issuer official.

The second possible reading is that one must look at the party committee's or PAC's expenditures and determine whether its expenditures on issuer officials constitute a large enough of a portion of its total expenditures. Essentially, it is a dilution standard to determine whether the broker-dealer would have reason to believe that its contribution is going to directly or indirectly help issuer officials. Under this reading, contributions to national party committees and federal leadership PACs would generally be permitted.

It is highly unlikely that the proposed Q&As were intended to have the former strict meaning. Indeed, the other due diligence requirements in the

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See also Perry v. Bartlett, 231 F.3d 155, 161 (4th Cir. 2000) (striking down an intent-based statute as unconstitutionally overbroad: "[d]iscerning the 'intent' of an organization...can be problematic, even if some in the organization 'admit' their intent").

[10] *Iowa Right to Life Committee v. Williams*, 187 F.3d 963, 969 (8th Cir. 1999) (citing *Buckley*, 424 U.S. at 43, and noting the notice problems that accompany an intent-based regulation).

proposed Q&As would be superfluous if that were the case given that no party committee or PAC would be permissible. Consequently, the MSRB should confirm the Activity Test as being the dilution standard described above where a broker-dealer may rely on assurances from a party committee or PAC that it uses an acceptable portion of its funds on non-issuer officials. However, for broker-dealers to be able to apply this dilution standard, the MSRB must clarify at what point a party committee or PAC gives to enough non-issuer officials to avoid an indirect ban. For example, is it enough that 50%, 60% or 70% of a state party committee's expenditures are used for non-issuer officials? Moreover, to be able to make this calculation, the MSRB must clarify the time period over which one would look to determine the percentage and regarding which the party committee or PAC would provide its assurances.

4. National Party Committees and Federal Leadership PACs Should Be Expressly Permitted

As described above, contributions to national party committees and federal leadership PACs appear to be permitted under the due diligence standards established by the proposed Q&As. Indeed, national party committees raise hundreds of millions of dollars primarily for non-issuer official federal candidates, and thus are more than sufficiently diluted. Moreover, federal leadership PACs are controlled by an incumbent U.S. Senator or Representative to contribute to his or her colleagues in Congress or to other federal candidates.

Thus, for the sake of simplicity, the MSRB should expressly state that contributions made to a national party committee or federal leadership PAC are permitted under the proposed Q&As as long as (1) the contribution was not solicited by an issuer official, and (2) the party committee or leadership PAC is not controlled by an issuer official. If they do not satisfy both of the above requirements, a broker-dealer would have to take whatever due diligence steps that ultimately become effective for such contributions.

5. The Prohibition on Soliciting Contributions to State and Local Party Committees Should Be Modified

As described above, the MSRB proposes prohibiting the solicitation of contributions on behalf of state and local party committees altogether, while ostensibly permitting contributions to be made to such party committees pursuant to the due diligence requirements described above. It does not make any sense to impose a greater, absolute prohibition on soliciting contributions than on making contributions. Indeed, the act of soliciting contributions does not pose a greater threat of pay-to-play than making contributions. This is recognized under Rule G-

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37's current language in that the prohibitions on making and soliciting contributions are co-extensive (i.e., broker-dealers and MFPs are prohibited from making or soliciting contributions to issuer officials). The same approach should be taken in the proposed amendment by permitting broker-dealers and MFPs to solicit contributions on behalf of state and local party committees to the same extent they are allowed to make contributions to them.

6. The Term Affiliated PAC Should Be Clarified

The proposed Q&As suggest that a broker-dealer establish an informational barrier between it and its "affiliated PAC" if that PAC gives to issuer officials. Although this is the first time that Rule G-37 brings in the concept of an "affiliated PAC," the MSRB does not clarify what it means. For example, does it mean a PAC controlled by a wholly-owned affiliate or is partial ownership enough? Given that companies could have varying degrees of ownership in other companies without having any influence over their day-to-day decisions, the MSRB should clarify "affiliated PAC" to mean a PAC that is controlled by a wholly-owned affiliate of the broker-dealer.

We look forward to discussing these issues further with the MSRB staff, and appreciate your attention to our comments. Please contact the undersigned at 646.637.9230 or via e-mail at lnorwood@bondmarkets.com with any questions that you might have.

Sincerely,

Leslie M. Norwood
Vice President and
Assistant General Counsel

cc: ***Securities and Exchange Commission***
The Honorable William H. Donaldson, Chairman
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
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